Registered Charities Newsletter

BN/Registration Number

****LAST PRINTED AND MAILED NEWSLETTER****
(For more details please read the column "From the Director General")

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From the Director General

The report of the Joint Regulatory Table (JRT) was presented to the Ministers of Finance and National Revenue in May 2003. Staff in the Charities Directorate, along with colleagues from the Department of Finance, will be actively engaged in developing the response of the Government of Canada.

To this end, the Directorate has created the position of Executive Director, Regulatory Renewal Secretariat, and John Walker, most recently of Human Resources Development Canada, has joined us to lead this work. The recommendations by the JRT deal with some of the most salient areas of federal charity regulation and will be considered seriously and speedily.

In addition, Carl Juneau has been assigned to the Appeals Branch, where he will be responsible for further considering and possibly implementing an internal appeals process for charities, as was recommended by the JRT. As a result, we are pleased to welcome Terry de March as Director of the Policy and Communications Division. Prior to this assignment, Mr. de March was Director, Innovations, Analysis and Integration Directorate, Justice Canada. Along with a strong policy development background, Mr. de March has extensive experience with regulatory issues affecting charities. Mr. de March participated in both the JRT and the former Regulatory Framework Table (as part of the 1999 Joint Tables Process).

The Future Directions Initiative continues to seize the attention of many of us within the Directorate as we establish our plans, available resources, and priorities.

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We are working with other parts of the Canada Customs and Revenue Agency (CCRA), and I hope soon to be in a position to share with you our priorities for the next year. For instance, we have identified a Reminder-to-File project as being of high benefit to charities that risk revocation for non-filing (as well as to our Determinations staff who deal with close to 1,200 requests for re-registration each year).

The creation of an advisory committee was one of the key Future Directions proposals and is also cited in the JRT's report. We have begun to consider what the nomination process for this committee might look like. We will be sharing these details with you in an upcoming newsletter.

Another important change is that, facing competing priorities and limited resources, we are turning to greater use of electronic means to communicate with charities. We are making our Web site more robust. We are also establishing an electronic mailing list that will let you know about new publications. You can sign up for this distribution on the CCRA's Web site at **www.ccra.gc.ca**.

In keeping with our effort to make better use of the technology that has become so much a part of our everyday lives, we have decided to no longer print and mail this newsletter. In the future, it will be available on our Web site. Those who have signed up for the electronic mailing list will be alerted as new issues are produced. We believe that almost all charities now have access to the Internet, whether it be at the charity work site or in the workplace and homes of staff and board directors. For exceptional cases where a charity lacks this access, it can request a paper copy of the Internet publication by calling our toll-free number listed under the "Contact us" section of the newsletter.

Change is a certainty, but we trust the alternatives will be effective, and that ongoing feedback will drive change that benefits us all.

Your input

Survey of charities

Last fall, we hired COMPAS Inc. to conduct a survey of charities' satisfaction with services provided by the Charities Directorate. COMPAS interviewed people from 600 charities that had been registered during the previous three years.

Some of the highlights were:

- 77% expressed satisfaction with the overall quality of service received from the Charities Directorate, with only 5% expressing dissatisfaction and the rest being neutral.
- As well, most clients said the service met (67%) or exceeded (15%) their expectations.
- 76% said they had received "just enough" general charities-related information from the Charities Directorate.
- When asked about the type of information they would like to hear about, policy changes and new rules were cited most frequently (33%), followed by reminders of policies and regulations (11%).
- 65% were aware of the Road Show.
- There was a similarly high level of awareness about the newsletter - 80% said they knew about it. Of these, 80% said they read some or most of it.

Of those who indicated that they had contacted the Charities Directorate within the previous year:

- 83% were satisfied with the quality of service they received by phone, with only 6% expressing dissatisfaction; and
- 74% were satisfied with the quality of service they received by mail or fax, with only 7% expressing dissatisfaction.

The aspects of service that were rated least positively were:

- the extent to which respondents felt they were well informed about where to look for information about Directorate services (55%); and
- the extent to which they were informed about the services (50%).

In future issues of this newsletter, we will offer more information about Directorate services and guidance on where to find other government services that are of interest to charities.

We will use the 2002 results as a benchmark for future improvements, and we plan to continue to survey client satisfaction on a regular basis.

We want your input on future topics for the newsletter

Are there any topics that you would like covered through this newsletter? We would like to hear your ideas for future editions. These can be in the form of a question for the **Did you know?** section of the newsletter or a topic for a more in-depth piece. We are particularly interested in topics that will be of interest to a large number of charities.

Please send your ideas to us at:

The Charities Newsletter
Charities Directorate
Canada Customs and Revenue Agency
Ottawa ON K1A 0L5

You can also contact us by e-mail at:

charities-bienfaisance-bulletin@ccra-adrc.gc.ca

Although we will not be able to reply, we will use your comments to improve the newsletter.

Did you know?

Our charity is ceasing operations. What do we need to do about the charity's registration?

A registered charity can apply in writing to have its registration revoked, such as when it winds up its operations. This is known as "voluntary revocation," as opposed to revocation because of non-compliance. Voluntary revocation is the process to follow when a registered charity asks the Charities Directorate to remove its name and discontinue its tax privileges.

Before we put the legal process into effect, we remind the charity of the consequences of revocation:

- it is no longer exempt from Part 1 tax, unless it qualifies as a non-profit organization;
- it cannot issue official donation receipts, and
- it may be subject to the revocation tax.

Under the *Income Tax Act*, an organization cannot qualify as a non-profit organization if it can be registered as a charity. As a result, theoretically at least, a charity cannot be exempt from tax unless it is a **registered** charity. Therefore, voluntary revocation is only appropriate when a charity is actually winding-up.

Revocation takes effect on the day when the CCRA publishes a notice that names the charity in the *Canada Gazette*. In the case of voluntary revocation, this occurs immediately after we mail the notice of proposed revocation to the charity- a necessary step in the legal process.

The Charities Directorate then sends the charity a letter requesting the following within six months of the end of the charity's fiscal year in which revocation took place:

- a *Registered Charity Information Return* with supporting financial statements that reflect the charity's operation for any outstanding years; and
- a statement detailing the name, address, and official registration number of the qualified donee(s) to which the charity's remaining assets have been (or will be) distributed.

A registered charity should file its information returns right up to the date of revocation. For example, if a charity's fiscal period ends December 31 and it is dissolved effective January 15, the charity must file two final returns. One return must be filed for the fiscal year ending December 31 and one for the two-week period beginning January 1 and ending January 15, because a charity's filing period cannot exceed 12 months.

On rare occasions, it becomes apparent that an organization should never have been registered as a charity because it never met the substantive requirements of the law. In these cases, the Minister of National Revenue can correct the mistake by annulling the registration. This solution is more advantageous to the organization than revocation because it does not result in a revocation tax on the organization's assets.

An annulment is only appropriate where an error in law was made. This will not be considered if a registered charity changed its focus after registration to non-charitable activities, or if the request is solely based on the charity no longer wanting to be registered.

How can I be certain that my organization's T3010A, has been received?

When a charity files a T3010A for fiscal periods ending in 2003 or later, the Charities Directorate will send a Notice of Confirmation to acknowledge that it has received and processed the charity's return. The Notice verifies the calculation of the totals reported for assets, liabilities, revenue, and expenditures. In addition, the Notice includes information on what the charity's disbursement quota (DQ) should be for the year filed and a calculation of whether or not the charity met this DQ. It also provides the charity with an estimate of the current year's DQ. These amounts are calculated based on the information provided by the charity in its return.

Although charities can lose their registration because they failed to file their T3010, this will only occur after we have sent the organization a Form TX11D, *Request for Return to be Filed*, and Form T2051A, *Notice of Proposed Revocation*. These forms and the consequences of receiving them are described below.

Returns that are mailed close to the deadline for filing may arrive too late to allow us to stop a computer-generated notice from being sent out to the charity. The notice warns a charity that it may lose its registration unless it files its return within 30 days. If you receive this notice after filing the return, you can call the Charities Directorate to confirm that we have received the return. Taking into account both mailing time and the time needed to key information into the system, we typically enter information about receiving a T3010 in our database two weeks after the form has been mailed.

Why are you sending me these forms (TX11D, TX11E, T2051A, T2051B)?

Q. I received Form TX11D, *Request for Return to be Filed*, in the mail. What does this mean?

A. Form TX11D is a notice that advises the charity that we did not receive its T3010 return by the due date (six months from the charity's fiscal period end). The charity is asked to file the return within 30 days so that its continued registration will not be jeopardized.

Please note:

Technically, a charity that has not filed after the six-month deadline is in breach of the Act. Despite the system of computer-generated notices just described and the work underway on the Reminder-to-File project, the CCRA can theoretically act against a late-filing charity on the day following the six-month deadline as long as due process is followed. The CCRA is considering posting the names of late-filing charities on its Web site.

Q. I received Form TX11E, *Notice of Filing Omission*, in the mail. What does this mean?

A. Form TX11E is a notice that advises the charity that the return it filed did not include the required financial statements. Each return filed must include a statement of revenue (receipts) and expenditures (disbursements) and a statement of assets and liabilities. Such financial statements should be submitted as soon as possible.

Q. I received Form T2051A, *Notice of Proposed Revocation*, in the mail. What does this mean?

A. Form T2051A is a notice sent by registered mail that advises the charity that we have not received a response to our last request to file a return. The charity must file the return within 30 days from the mailing of the notice. If it fails to do so, the charity's registration will be revoked in a notice published in the *Canada Gazette*.

Q. I received Form T2051B, *Notice of Revocation of Registration*, in the mail. What does this mean?

A. Form T2051B is a notice that advises the charity that its registration has been officially revoked. When a charity's registration is revoked, it loses both its tax-exempt status and its authority to issue official donation receipts for income tax purposes. The charity may also have to pay a revocation tax equal to the fair market value of its remaining assets.

Q. I received Form T2046, *Tax Return Where Registration of a Charity is Revoked*, in the mail. What does this mean?

A. Form T2046 is the return used to calculate the potential revocation tax. It is mailed together with Form T2051B. The charity has one year from the date of revocation to file Form T2046.

What is the revocation tax?

When a charity's registration is revoked, it has to pay a revocation tax. This tax must be paid on or before the day that is one year after the charity's effective date of revocation (the payment day). The revoked charity has to complete and file Form T2046, *Tax Return Where Registration of a Charity is Revoked*, on or before the payment day. This must be done whether or not any amount is due.

To determine the amount of the revocation tax involved, the following amounts, A and B, are added:

A. the fair market value of the charity's assets as they were 120 days before the CCRA mailed its notice of proposed revocation to the charity (the valuation day); and

B. the amount of receipted donations and gifts the revoked charity received between the valuation day and the payment day (the winding-up period).

From the total amounts A and B, the revoked charity can subtract the following expenditures made during the winding-up period:

1. the fair market value of all assets it transferred to qualified donees;
2. all amounts it spent on charitable activities; and
3. all other amounts it spent on reasonable expenses or for debts outstanding as of the valuation day.

The revocation tax payable is whatever remains after subtracting items 1 through 3 from the total of A and B. This amount is to be paid to the Receiver General for Canada. If nothing remains after doing the calculation, no revocation tax is payable.

Revoked charities are not to dispose of assets other than for 1, 2, or 3. After the valuation day, a person (other than a qualified donee) who receives an amount from the charity will - unless the amount is included in items 1 to 3 or is consideration given by the person in respect of such an amount - be jointly and severally liable with the charity for any related revocation tax payable. Liability would not extend to those who received legitimate and reasonable payments, such as salaries, fees for work, or payment for goods provided.

Issues:

Amalgamations, mergers, and consolidations

Sometimes two or more charities combine into a single charity. This can happen because government has imposed the merger. For example, this was the case for hospitals in some provinces. Charities can also choose to join together as one body in response to changing circumstances or changed objectives.

Charities that choose to combine can accomplish this through an amalgamation, merger, or consolidation. Although these terms are sometimes used interchangeably, there are important distinctions between them for charities. Charities should seek guidance from the Charities Directorate before embarking on any of these measures.

What do we mean by amalgamations, mergers, and consolidations?

Amalgamations

When two or more charities amalgamate they bring their membership, assets, and liabilities into the entity that emerges. However, the original charities do not cease to exist or dissolve. While they no longer have separate identities, they continue their existence within a single entity - the amalgamated charity.

Mergers

In mergers, one entity winds up its affairs and transfers its assets to another.

Consolidations

In consolidations, all the original bodies dissolve and transfer their assets to a new entity.

How do such organizational structures affect the use of Business Numbers (BNs)?

Each of these organizational structures affects the use of BNs differently.

In the case of **amalgamations**, one BN is retained and used by the amalgamated body. The other BN(s) will be terminated. The charity will usually be able to choose which BN it retains.

With **mergers**, the body proposing to dissolve undergoes voluntary revocation of its registration. The BN of the other remaining organization is not affected. The assets are all transferred to the remaining organization.

In the case of **consolidations**, all original bodies are considered to undergo voluntary revocation. The new consolidated body needs to submit an application for registration and, if accepted, will typically be given a new BN.

Donations of items of a speculative value

For some time, the Charities Directorate has cautioned registered charities about issuing official donation receipts for gifts-in-kind for amounts exceeding their fair market value. Of particular concern are donations of art and other items of speculative value, such as trading cards, comic books, and used cars, where a promoter facilitates the donations to the charity.

Because so many of these donation arrangements involved art, they are often referred to as "art-flips." In November 2002, the CCRA issued a Fact Sheet concerning these arrangements. You can find the Fact Sheet on the CCRA Web site at: **www.ccra.gc.ca/newsroom/factsheets/2002/nov/art-e.html**

These "art-flips" are arrangements where a promoter arranges for a taxpayer to purchase property at a relatively low price and to donate it to a registered charity. The charity then issues a tax receipt based on an appraisal arranged by the promoter that is substantially higher than the cost to the donor. When the tax receipt is claimed on the donor's tax return, it generates a tax saving that is higher than the amount paid for the donated property. Such arrangements can result in a significant cost to the tax-paying public.

Charities should be wary of situations where they are approached with pre-arranged donations. They must ensure that any official donation receipts issued for gifts-in-kind are for fair-market value. For gifts over $1,000, the CCRA recommends that the fair market value be determined by an independent appraisal performed by a competent professional who is not financially associated with the donor, promoter, or item being donated.

A charity should not lose sight of the fact that it is the amount for which the receipt is issued that is included in its disbursement quota requirement for the following year, even though the charity may in turn sell the property for an amount far below the amount for which the receipt was issued. Failure to meet the disbursement quota is grounds for us to revoke a charity's registered status. In these cases, the charity gambles that the property will be worth at least the receipted amount at some future time.

Charities that issue receipts for amounts in excess of the fair market value of the donated property risk losing their registered status. To date, two charities have lost their registered status for issuing receipts that contain false information.

Charities may also be liable for third-party civil penalties if they knew or ought to have known that the appraised values were incorrect. This penalty was instituted to deter third parties from making false statements or omissions and is based on the amount of tax the third party allows others to avoid. For more information, see Information Circular 01-1, *Third-Party Civil Penalties*, which is available on the CCRA Web site at: **www.ccra.gc.ca/formspubs/technical/penalties-e.html**

To date, over 3,000 donors have been re-assessed for almost $70 million in federal taxes for donations of art. Penalties have been applied in cases where donors demonstrated gross negligence by having obtained receipts for works of art showing a value several times their true fair market value - a fact they knew or ought to have known. As a result, the Federal Budget of February 2003 has proposed expanding the definition of tax shelters to include such donation schemes, which means that promoters of these arrangements will have to register them with the CCRA for donors to receive the associated tax benefits.

Charities are reminded that they are not obliged under the *Income Tax Act* to issue official donation receipts for gifts; nor are they required to accept gifts. Before accepting gifts-in-kind, charities should ask themselves how the gift would allow them to further their charitable purposes. Charities that have **specific questions about donation schemes** should contact the Compliance Section of the Charities Directorate at (613) 948-2463.

Important reminder for those selling annuities to donors

The new split-receipting policy expressed in the *Income Tax Technical News* No. 26, dated December 24, 2002, applies to all annuities issued on or after December 21, 2002. As a result of this change, Interpretation Bulletin IT-111R2, *Annuities Purchased from Charitable Organizations*, and its Special Release dated February 10, 1997, have been cancelled. However, for annuities issued before December 21, 2002, the policy expressed in these documents continues to apply. You can find the *Income Tax Technical News* on the CCRA Web site at **www.ccra.gc.ca/tax/technical/incometax/itnews3-e.html**. You can also obtain a copy from your tax services office.

Update: Supreme Court of Canada rules that proposed lottery would violate gambling laws

On March 11, 2003, the Supreme Court of Canada ruled on Earth Future Lottery's appeal of the Supreme Court of P.E.I.'s judgment that its proposed Internet lottery would not be legal. This earlier decision of the Supreme Court of P.E.I. was mentioned in the Federal Court of Appeal's unanimous dismissal of Earth Fund/Fond Pour La Terre's ("Earth Fund") appeal of the CCRA's decision to refuse to register it as a charity. No organization will be recognized as charitable in law if its activities are illegal.

In its decision, the Supreme Court of Canada agreed with the earlier ruling. It found that the Earth Future Lottery, which Earth Fund planned to run, would break the country's gambling laws because it would be selling tickets across provincial boundaries.

Policies:

New rules for determining whether a charity is a private foundation

In the last issue of this newsletter, we discussed how the draft technical amendments to the *Income Tax Act* released by the Department of Finance in December 2002 were going to affect the treatment of gifts under the Act. A second aspect of the Department of Finance's draft technical amendments will affect the designation of certain registered charities (mostly private foundations) now and in the future.

Under the new provisions, the "composition of the board test" and the "contributors test," which apply in the determination of whether a charitable foundation is a public or private foundation, are going to change.

The Department of Finance's draft technical amendments to the *Income Tax Act* are available online at: **www.fin.gc.ca/news02/02-107e.html**

Guidance on public benefit

The Charities Directorate is making available draft guidelines dealing with public benefit. Public benefit is a concept that is central to our understanding of charity. However, the meaning of "public" and of "benefit" has been unclear and led to confusion. What groups can constitute a segment of the public? What kinds of benefits are we talking about? Can they be measured? Must they be the direct result of the organization's efforts? Through these draft guidelines, we hope to clarify some of the requirements under the law for organizations that wish to be recognized as charitable.

This policy will be discussed in more detail in the next issue of this newsletter. The draft guidelines will be available for consultation until October 31, 2003. You can find a copy of these guidelines, along with other publications for consultation, on the "Consultation on proposed policy" page of the CCRA Web site. You can also order a copy of this draft policy by calling our toll-free Client Assistance number.

Contact us

You can call us toll free at 1-800-267-2384 (English) or 1-888-892-5667 (bilingual).

You can also write to us at:

Charities Directorate
Canada Customs and Revenue Agency
Ottawa ON K1A 0L5

You can find all our publications at:
www.ccra.gc.ca/charities/

Draft publications for consultation are available at:
www.ccra.gc.ca/tax/charities/consultation_policy-e.html

New information for charities is announced on the "What's new" page for charities on the CCRA Web site at: **www.ccra.gc.ca/tax/charities/whatsnew/whatsnew-e.html**